Supreme Court, U.S.
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No. 84-1036 (4)

In the Supreme Court of the United States

OCTOBER TERM, 1984

ANTHONY MATERIA, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

DANIEL L. GOELZER
General Counsel

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

ROSALIND C. COHEN
Assistant General Counsel

ROBERT MILLS
Special Counsel
Securities and Exchange Commission
Washington, D.C. 20549

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QUESTIONS PRESENTED

Petitioner, an employee of a financial printer, misappropriated confidential information concerning planned tender offers entrusted to his employer by its tender offeror clients. He purchased the securities of the target companies on the basis of this information and tipped others who also purchased. Petitioner and his tippees subsequently sold those securities at a profit after the tender offers were announced publicly.

The questions presented are:

1. Whether petitioner's conduct violated the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5, 17 C.F.R. 240.10b-5.

2. Whether petitioner's conduct violated Section 14(e) of that Act, 15 U.S.C. 78n(e), and Rule 14e-3, 17 C.F.R. 240.14e-3, which prohibit persons from tipping, or trading on, nonpublic information concerning tender offers acquired from the target or offeror.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-14a) is reported at 745 F.2d 197. The opinion of the district court (C.A. App. 26-84) is unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 15a-16a) was entered on October 1, 1984. The petition for a writ of certiorari was filed on December 27, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Anthony Materia was employed by a financial printer, Bowne of New York City, Inc. (Pet. App. 3a; C.A. App. 189, 204, 274). Bowne printed various confidential materials, including documents for use by its corporate clients in connection with planned tender offers for the

securities of other companies (Pet. App. 3a; C.A. App. 243, 245-246). Because of the need for the strictest secrecy prior to the commencement of tender offers, Bowne's tender offeror clients omitted the names of the target corporations and certain (but not all) identifying information from early drafts and proofs of the offering documents (Pet. App. 3a; C.A. App. 217-219, 223-226, 232-236, 241-242, 253-254, 256-258). In addition, Bowne had a written policy explicitly forbidding its employees from using information obtained through their employment for their own benefit (Pet. App. 4a; C.A. App. 245-249, 261-262, 267, 289-292).

Despite these precautions, petitioner, who worked in the printing plant at Bowne, discerned the identities of four of the target corporations from draft offering documents at Bowne and misappropriated that information, using it to purchase the securities of the target companies before the tender offers were publicly announced (Pet. App. 3a-4a; C.A. App. 243-244, 260, 280-288). In addition, petitioner tipped nonpublic information concerning the proposed tender offers to his wife, his stepson, and others, who also purchased the targets' securities (C.A. App. 268-274, 277-288, 297-306). Following public announcement of the tender offers, petitioner and the others sold or tendered their shares, realizing substantial profits (Pet. App. 4a).

2. The Securities and Exchange Commission brought this civil enforcement action against petitioner in the United States District Court for the Southern District of New York. The district court concluded that in trading on nonpublic information he had misappropriated from his employer and its tender offeror clients, petitioner violated Sections 10(b) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and 78n(e), and Rules 10b-5 and 14e-3, 17 C.F.R. 240.10b-5 and 240.14e-3 (C.A. App. 59, 76-77,

183).[1] The court determined that there was a likelihood that petitioner would violate the federal securities laws in the future and issued a permanent injunction restraining him from violating those provisions (C.A. App. 18-22, 68-69). The court also ordered petitioner to disgorge profits of $99,862.50 obtained as a result of his illegal trading (C.A. App. 22-24, 71-72).[2]

The court of appeals affirmed (Pet. App. 1a-14a). The court noted that petitioner "does not contest the district court's finding that he misappropriated confidential information and traded on it to his advantage" (*id.* at 7a). The court reasoned that a financial printer's reputation as a safe repository for its clients' secrets is among its "most valuable assets" (*id.* at 9a) and that petitioner's "theft of information was indeed as fraudulent as if he had converted corporate funds for his personal benefit" (*ibid.*). The court of appeals then rejected petitioner's contention that he did not violate Rule 10b-5 because his conduct was not "in connection with the purchase or sale of any security" within the meaning of

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[1]Section 10(b), as implemented by Rule 10b-5, makes unlawful any manipulative or deceptive device or contrivance in connection with the purchase or sale of a security.

Section 14(e) prohibits the making of any false or misleading statement or the use of any fraudulent, deceptive, or manipulative acts or practices in connection with any tender offer, or request or invitation for tenders, or any solicitation of shareholders in opposition to or in favor of any such offer, request, or invitation. In addition, Section 14(e) directs the Commission to adopt rules to define such acts and to prescribe "means reasonably designed" to prevent them.

Pursuant to that directive, the Commission has adopted Rule 14e-3, which prohibits persons who have learned, from the bidder or the target, of a planned tender offer from purchasing the target company's shares or tipping the information to others.

[2]The court did not require petitioner to disgorge profits realized by the persons who traded on the information he supplied to them (C.A. App. 70-71).

that rule (Pet. App. 12a-13a); the court explained that "[t]he information [petitioner] stole ha[d] no value whatsoever except 'in connection with' his subsequent purchase of securities" (*ibid.*) and that petitioner's misappropriation of information "was part and parcel of a larger design, the sole purpose of which was to reap instant no-risk profits in the stock market" (*id.* at 13a). The court concluded that "one who misappropriates nonpublic information in breach of a fiduciary duty and trades on that information to his own advantage violates Section 10(b) and Rule 10b-5" (*id.* at 12a; footnote omitted).[3]

ARGUMENT

The decision of the court of appeals is correct, and petitioner does not even assert that there is a conflict among the circuits. The Second Circuit is the only court of appeals that has considered the issues petitioner raises concerning Section 10(b) and Rule 10b-5, and no court of appeals, including the court below, has addressed the issues petitioner raises with respect to Section 14(e) and Rule 14e-3. Further review is therefore unwarranted.[4]

1. a. Section 10(b) and Rule 10b-5 prohibit fraud in connection with the purchase or sale of securities (15 U.S.C. 78j(b); 17 C.F.R. 240.10b-5), and this Court has consistently construed these provisions broadly. See, *e.g.*, *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 386 (1983) (Section 10(b) should be construed so as to effectuate its "broad

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[3]The court of appeals stated that because it had concluded that petitioner's conduct violated Rule 10b-5, it was unnecessary to consider petitioner's contentions concerning Rule 14e-3 (Pet. App. 12a n.5).

[4]We note in addition that petitioner's contentions are very similar to those advanced unsuccessfully by the petitioner in *United States* v. *Newman*, 664 F.2d 12 (2d Cir. 1981), aff'd after remand, No. 82-1273 (2d Cir Feb. 8, 1983), cert. denied, 464 U.S. 863 (1983), although in *Newman*, the petitioner's sentence for violating the securities laws was concurrent with his sentence on other charges. See 82-1653 Br. in Opp. 9.

proscription against fraud"); *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151 (1972) ("These proscriptions, by statute and rule, are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive."); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 203 (1976) (Section 10(b) is "a 'catchall' clause to enable the Commission 'to deal with new manipulative or cunning devices' ") (brackets omitted); *United States* v. *Naftalin*, 441 U.S. 768, 773, 775-777 (1979). See also S. Rep. 792, 73d Cong., 2d Sess. 6 (1934).

As the court of appeals noted, "[a]gainst this expansive construction of 'fraud or deceit,' [petitioner's] theft of information was indeed as fraudulent as if he had converted corporate funds for his personal benefit" (Pet. App. 9a). Petitioner does not deny that he misappropriated — "stole to put it bluntly" (*Chiarella* v. *United States*, 445 U.S. 222, 245 (1980) (Burger, C.J., dissenting)) — confidential information in breach of a fiduciary duty or other relationship of trust and confidence (see *id.* at 228). "In other areas of the law, deceitful misappropriation of confidential information by a fiduciary, whether described as theft, conversion, or breach of trust, has consistently been held to be unlawful." *Newman*, 664 F.2d at 18 (citations omitted). Indeed, in *Dirks* v. *SEC*, No. 82-276 (July 1, 1983), even though the issue was not before the Court, the Court strongly suggested that trading on "misappropriate[d] or illegally obtain[ed] * * * information" — the activity in which petitioner unquestionably engaged — would constitute fraud in violation of Rule 10b-5. See slip op. 18.[5]

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[5]In *Chiarella* v. *United States*, 445 U.S. 222 (1980), several Justices agreed that trading on misappropriated information would violate Rule 10b-5, even though the Court held (445 U.S. at 235-237) that that question was not presented in the case. See *id.* at 239 (Brennan, J., concurring); *id.* at 239-243 (Burger, C.J., dissenting); *id.* at 245 (Blackmun, J., dissenting). In other contexts, this Court has found similar

b. Instead of denying the fraudulent character of his actions, petitioner contends primarily that he did not violate Section 10(b) and Rule 10b-5 because the fraud was not committed against a purchaser or seller of securities. See, *e.g.*, Pet. 13-15, 18-21. The first difficulty with petitioner's contention is that he *did* defraud parties to securities transactions — the tender offerors who entrusted confidential information to Bowne. The Commission alleged and the courts below found (Pet. App. 3a-5a) that the information misappropriated by petitioner had been entrusted to Bowne by its tender offeror clients. As the court of appeals noted (*id.* at 3a), "[b]ecause even a hint of an upcoming tender offer may send the price of the target company's stock soaring, information regarding the identity of a target is extremely sensitive and zealously guarded." Indeed, Bowne had no independent interest in maintaining the secrecy of this information; it sought to do so precisely because of the value of the information to its clients. Thus, when petitioner stole that information and traded on it, he breached a duty both to his employer and to a party to a securities transaction, the tender offeror.

More fundamentally, there is no basis for petitioner's contention that he did not violate Rule 10b-5 unless he defrauded a purchaser or seller of securities. The plain language of Section 10(b) and Rule 10b-5 prohibits fraud "*in connection with* the purchase or sale of any security" (emphasis added), and petitioner's fraud unquestionably satisfies this criterion. As we have noted, the court of appeals pointed out that the information petitioner stole had "no value whatsoever except 'in connection with' his subsequent purchase of securities" and was "part and parcel

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breaches of a fiduciary duty to be fraudulent. See, *e.g.*, *United States* v. *Carter*, 217 U.S. 286, 305-310 (1910); *Wardell* v. *Railroad Co.*, 103 U.S. 651, 654-659 (1880).

of a larger design, the sole purpose of which was to reap instant no-risk profits in the stock market" (Pet. App. 13a). See *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12-13 (1971) (emphasis added) (Section 10(b) reaches "deceptive practices *touching* [the] sale of securities as an investor").

Petitioner also appears to be attempting to invoke the principle (see *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975)) that a *private* civil damages action under Section 10(b) may be brought only by a purchaser or seller of securities. But as this Court has expressly held, that limitation on private damages actions has no application to a government enforcement proceeding. *Id.* at 751 n.14; see *Naftalin*, 441 U.S. at 774 n.6. See also *id.* at 772 ("The statutory language [of Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), on which Rule 10b-5 was patterned] does not require that the victim of the fraud be an investor.").

c. There is no merit to petitioner's contention (Pet. 14, 20) that the decision of the court of appeals is inconsistent with *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977). *Santa Fe Industries* held that mere unfairness in a securities transaction, "without any deception, misrepresentation, or nondisclosure," does not violate Rule 10b-5. 430 U.S. at 476. But petitioner was not alleged simply to have acted unfairly. As this Court recently said in discussing *Santa Fe Industries*, fraud in an insider trading case arises from " 'tak[ing] advantage' of 'information intended to be available only for a corporate purpose and not for the personal benefit of anyone' * * * and thus mak[ing] secret profits." *Dirks*, slip op. 7 (citations omitted). This, of course, precisely describes petitioner's conduct.

Petitioner's claim (Pet. 22-24) that the court of appeals' decision implemented an "equal information" rule under Section 10(b) is erroneous for similar reasons. The court of

appeals in this case did not conclude that petitioner violated Section 10(b) and Rule 10b-5 merely because he traded while in possession of nonpublic information: it held that he violated those provisions because he traded on information he had deceitfully misappropriated (Pet. App. 9a).[6]

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[6]Petitioner's other arguments are likewise without merit. Petitioner asserts (Pet. 32-33) that a "dichotomy" in the law has been created by the Second Circuit's decisions in this case and in *Moss* v. *Morgan Stanley, Inc.*, 719 F.2d 5 (1983), cert. denied, No. 83-950 (Feb. 21, 1984). *Moss* was a private damages action against Newman, who had been held criminally liable in *United States* v. *Newman, supra*, for trading in the market on the basis of nonpublic information misappropriated from a tender offeror and its investment banker. In *Newman*, the Second Circuit upheld the imposition of criminal liability on this basis. But *Moss* was a suit by a party who sold shares of the target corporation in the market on the same day that Newman purchased the target's shares, and the Second Circuit denied recovery on the ground that Newman owed no duty of disclosure to that party. *Moss* is therefore simply an application of the principle that while the elements of fraud are the same in both government enforcement actions and private suits under Rule 10b-5 (see *Aaron* v. *SEC*, 446 U.S. 680, 691 (1980)) a private plaintiff may not recover damages unless he can demonstrate that *he* was defrauded; by contrast, as the court of appeals in this case again recognized (Pet. App. 11a), in a government enforcement action the focus is not "the precise dire tion" of the fraud but whether the defendant has committed a fraud that violates Rule 10b-5.

It is unclear why petitioner discusses (Pet. 15-17) the Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 *et seq.*; that statute does not further petitioner's argument in any way. In fact, when Congress enacted this legislation, it clearly understood that conduct such as petitioner's violates Section 10(b) and Rule 10b-5. See H.R. Rep. 98-355, 98th Cong., 1st Sess. 4 (1983). Indeed, the House Committee considering the Act cited the Second Circuit's decision in *Newman* with approval and noted that *Newman* had clarified this area of the law (H.R. Rep. 98-355, *supra*, at 5, 13).

2. Petitioner's conduct also violated Section 14(e) and Rule 14e-3.[7] This is an additional reason for the Court to deny certiorari. In contrast to the antifraud provisions of Rule 10b-5, which apply to securities transactions generally, Section 14(e) and Rule 14e-3 are specifically directed to tender offers. Section 14(e) was added to the Securities Exchange Act of 1934 as part of the Williams Act amendments (in 1968 and 1970) to prevent fraudulent and manipulative conduct in connection with tender offers. Pub. L. No. 90-439, 82 Stat. 454 *et seq.*; Pub. L. No. 91-567, 84 Stat. 1497 *et seq.* Rule 14e-3 promulgated thereunder prohibits persons from tipping, or trading while in possession of, information concerning proposed tender offers acquired from the offeror or target unless the information has been publicly disclosed.[8] The rule was designed to prevent market disruption in connection with tender offers and to eliminate unfair disparities in the information available to the trading public. See 45 Fed. Reg. 60410, 60412 (1980).

Petitioner does not deny — and cannot deny — that his conduct falls squarely within the prohibition of Rule 14e-3. Instead, petitioner contends (Pet. 30-31) that Rule 14e-3 is beyond the Commission's rulemaking authority under Section 14(e). This contention is foreclosed by both the language and the legislative history of Section 14(e).

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[7]Although the Commission, in the court of appeals, contended that the district court's judgment could be sustained on the basis of Section 14(e) and Rule 14e-3 (see Gov't C.A. Br. 20-29), the court of appeals chose to rely instead on Rule 10b-5. In considering the present petition, however, this Court may deem it relevant that an independent ground supports the district court's judgment.

[8]This case does not present the Section 14(e) issue involved in *Schreiber* v. *Burlington Northern, Inc.*, cert. granted, No. 83-2129 (Oct. 1, 1984) — whether fully disclosed conduct can be manipulative within the meaning of Section 14(e). There is no suggestion that petitioner fully disclosed the nature of the conduct in which he engaged.

a. Section 14(e) makes it "unlawful for any person * * * to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer * * *." It further provides that the Securities and Exchange Commission "shall * * * by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative." As we have explained, petitioner's conduct was fraudulent and deceptive. But even if it were not, it could be prohibited by regulation because Section 14(e) does not limit the Commission to prohibiting conduct that actually *is* deceptive, fraudulent, or manipulative; it permits the Commission to prevent such conduct by regulating activities which are not themselves deceptive, fraudulent, or manipulative.[9] Similarly, contrary to petitioner's suggestion (Pet. 28-30), the Commission's rulemaking authority under Section 14(e) is not limited to curtailing activities by the bidder and target. The language of that provision — "any person" — makes it clear that Congress intended no limitation as to persons.

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[9]In this respect, the language of Section 14(e) is different from the language of Section 10(b). Thus, petitioner's suggestion (Pet. 30) that his conduct cannot be proscribed under Rule 14e-3 because, in his view, *Dirks* v. *SEC*, *supra*, and *Chiarella* v. *United States*, *supra*, would foreclose liability under Section 10(b) and Rule 10b-5, is incorrect. Indeed, the Court in *Chiarella* recognized that the scope of Section 14(e) differs from that of Section 10(b); the Court noted the then proposed Rule 14e-3, indicating that under that rule the Commission contemplated barring certain trading activities in connection with tender offers. See 445 U.S. at 233-234.

Although not directly at issue in this case, there are other important differences between Sections 14(e) and 10(b). For example, Section 10(b) uses only the terms "manipulative" and "deceptive," while Section 14(e) expressly applies to "fraudulent" conduct as well. In addition, Section 14(e) does not use the terms "purchase" and "sale." By broadly proscribing misconduct "in connection with any tender offer," Section

b. The legislative history of Section 14(e) confirms these conclusions and demonstrates that Congress intended to authorize the Commission to prohibit conduct like petitioner's. In considering the scope of Section 14(e), Congress was specifically concerned with trading on nonpublic information about planned tender offers. Testimony in the congressional hearings explained that such trading could (i) alert others to the potential tender offer, spurring additional trading which could drive up the price of the target's stock and possibly thwart the offer; and (ii) work to the disadvantage of the target's shareholders, who would be pressured to sell their shares into a rising market without the full disclosure the Williams Act was intended to provide. *Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency,* 90th Cong., 1st Sess. 72-74 (1967) (*1967 Senate Hearings*).[10]

14(e) is designed to cover even those aspects of tender offer transactions that might not be viewed as involving a purchase or sale.

Finally, Section 14(e) uses the language "acts or practices." In contrast to Section 10(b), it does not contain the language "device or contrivance," which the Court cited in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976), in support of its conclusion that Section 10(b) requires scienter. Thus, Section 14(e) focuses on conduct that has certain undesirable *effects*, not on the culpability of the actor. See Section 17(a)(3) of the Securities Act of 1933, 15 U.S.C. 77q(a)(3), and Section 206(2) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-6(2); *Aaron* v. *SEC*, 446 U.S. 680, 694, 696-697 (1980); *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 200 (1963).

[10]The Senate Committee considering the legislation discussed

> the situation which makes it possible for insiders to take advantage of their knowledge that the pending offer is coming and therefore get a quick profit by buying stock with the sure knowledge that they are going to have a market for it * * *.

1967 Senate Hearings 74.

The legislative history of the 1970 amendments to Section 14(e), which gave the Commission the expansive rulemaking authority discussed above, also refers to the problem of trading on nonpublic information concerning an impending tender offer. In response to an inquiry by Senator Williams, the sponsor of the legislation, as to the type of conduct the Commission might prohibit by rule, the Commission cited the situation in which the following occurs (*Additional Consumer Protection In Corporate Takeovers and Increasing the Securities Act Exemptions for Small Businessmen: Hearing on S. 336, S. 3431 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency*, 91st Cong., 2d Sess. 12 (1970) (*1970 Senate Hearing*):[11]

> [A] person who has become aware that a tender bid is to be made, or has reason to believe that such bid will be made, may fail to disclose material facts with respect thereto to persons who sell to him securities for which the tender bid is to be made.

Thus, from the beginning Congress was well aware that the Commission could use its rulemaking authority under Section 14(e) to prohibit the precise type of conduct at issue here. Contrary to petitioner's suggestion (see Pet. 25), the legislative history in no way reflects an intent to limit that prohibition to persons who have a pre-existing relationship with the target company or its shareholders. In sum, there can be no doubt that Rule 14e-3 — which, as we have noted, petitioner does not deny having violated — is well within the Commission's rulemaking authority.[12]

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[11]We note that the rulemaking power was added in 1970 to broaden the Commission's authority to deal with problems relating to tender offers. 116 Cong. Rec. 3024 (1970) (remarks of Senator Williams); *1970 Senate Hearing* 2 (remarks of Senator Williams).

[12]Rule 14e-3 was also adopted pursuant to Section 23(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78w(a). That Section authorizes the Commission "to make such rules and regulations as may be

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

REX E. LEE
Solicitor General

DANIEL L. GOELZER
General Counsel

PAUL GONSON
Solicitor

JACOB H. STILLMAN
Associate General Counsel

ROSALIND C. COHEN
Assistant General Counsel

ROBERT MILLS
Special Counsel
Securities and Exchange Commission

APRIL 1985

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necessary or appropriate to implement the provisions" of the Securities Exchange Act of 1934. In construing a statute similar to Section 23(a), this Court has said that a duly promulgated agency regulation will be sustained so long as it is " 'reasonably related to the purposes of the enabling legislation.' " *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 369 (1973), quoting *Thorpe* v. *Housing Authority*, 393 U.S. 268, 280-281 (1969).

DOJ-1985-04